Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:
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TY:

Legend

Taxpayer =
Shareholder =
Partnership 1 =
Partnership 2 =
Partnership 3 =
Property =
Organization =
Tax Preparer =
Creditor 1 =
Creditor 2 =
State =
$A =
$B =
$C =
$D =
$E =
$F =
Year =
Date =

Dear :

This letter is in response to your October 12, 1999 request for a ruling on behalf of Taxpayer. Additional information was submitted on November 24, 1999 and January 28, 2000.

RULING REQUESTED

You have requested an extension of time to make an election under § 108(c) of the Internal Revenue Code. Specifically, you have requested an extension of time to make an election under § 108(c) and § 1.108(c)-1 of the Income Tax Regulations to reduce the basis of depreciable property and to exclude income resulting from the discharge of qualified real property business indebtedness.

FACTS

Taxpayer in this case is an S corporation. Shareholder is Taxpayer's sole shareholder. Taxpayer is an owner and operator of retail properties. To acquire assets for its business, Taxpayer incurs indebtedness which is secured by the acquired assets.

Taxpayer owns a 95 percent general partnership interest in Partnership 1. Partnership 1 held a 99 percent general partnership interest in Partnership 2 and a 1 percent general partnership interest in Partnership 3, which owns and operates Property in State. Partnership 2 also held a 99 percent general partnership interest in Partnership 3.

Property was subject to a nonrecourse loan from Creditor 1. During Year, Partnership 3 refinanced the Property with a loan from Creditor 2. In connection with the refinancing transaction, Creditor 1 agreed to accept as payment in full from Partnership 3 an amount that was $A less than the amount of the outstanding indebtedness owed to Creditor 1. This resulted in $A cancellation of debt income ("COD income").

The COD income realized by Partnership 3 was allocated to Partnership 3's partners as follows: $B to Partnership 2 and $C to Partnership 1. The COD income realized by Partnership 3 and allocated to Partnership 2 was then allocated by Partnership 2 to Partnership 2's partners; $D being allocated to Partnership 1. Partnership 1's total allocable share of Partnership 3's COD income amounted to $E ($C directly from Partnership 3 and $D indirectly from Partnership 2). Taxpayer's distributive share of the COD income allocated to Partnership 1 was $F.

Organization prepares the tax returns for both Taxpayer and Shareholder. Taxpayer's Federal income tax return for Year, which was timely filed on Date, was prepared by Organization. The return was prepared by a staff tax specialist with final review and signing of the return by Tax Preparer, Taxpayer's tax services coordinator. Tax Preparer is a certified public accountant with several years of tax experience.

Tax Preparer mistakenly understood the reference to "noncorporate taxpayers" in § 1.108-5(a) of the Regulations to mean that the election under § 108(c)(3)(C) was to be made at the shareholder, not the S corporation, level. Accordingly, in preparing

Taxpayer's Federal income tax return for Year, Tax Preparer reflected Taxpayer's distributive share of the COD income as other taxable income and did not make the § 108(c) election.

Taxpayer asserts that at all times it intended to treated the canceled indebtedness as qualified real property business indebtedness. Taxpayer states that it relied on Organization to prepare the election necessary to treat the canceled indebtedness as qualified real property business indebtedness. Organization failed to include the election in Taxpayer's Federal income tax return and failed to review the election procedures with Taxpayer or Shareholder.

Taxpayer represents that, if it is granted the extension to file the § 108(c) election, it will reduce its basis in depreciable real property pursuant to § 1017 of the Code and § 1.1017-1 of the of the Regulations. Shareholder will not increase Shareholder's stock basis in Taxpayer for the amount of the COD income that is excluded from gross income under § 108(a)(1)(D). Additionally, the partnerships in which Taxpayer owns an interest and that own depreciable real property will reduce the basis of their respective real property with respect to Taxpayer pursuant to § 1017(b)(3)(C) of the Code.

The Service has not contacted Taxpayer about its failure to make the § 108(c)(3)(C) election nor does Taxpayer believe that the Service discovered Taxpayer's failure to make the election on or before the date that the request was filed.

LAW AND ANALYSIS

Section 108(a)(1)(D) of the Code provides that gross income does not include any amount includible in gross income by reason of the discharge of indebtedness if, in the case of a taxpayer other than a C corporation, the indebtedness discharged is qualified real property business indebtedness. Section 108(c)(3) provides that the taxpayer must make an election in order to take advantage of the exclusion provided by § 108(a).

Section 108(d)(6) of the Code provides that in the case of a partnership, §§ 108(a) and 108(c) shall be applied at the partner level.

Section 108(d)(7)(a) of the Code states that in the case of an S corporation, §§ 108(a) and 108(c) shall be applied at the corporate level.

Section 1.108(c)-1(b) of the Income Tax Regulations provides that the election available under § 108(c)(3)(C) must be made on the timely-filed (including extensions) Federal income tax return for the taxable year in which the taxpayer has discharge of indebtedness income that is excludible from gross income under § 108(a). The election is to be made on a completed Form 982.

Section 301.9100-3 states that a taxpayer will be deemed to have acted reasonably and in good faith if the taxpayer--

(i) requests relief before the failure to make the regulatory election is discovered by the Service;
(ii) inadvertently failed to make the election because of intervening events beyond the taxpayer's control;
(iii) failed to make the election because, after exercising due diligence, the taxpayer was unaware of the necessity for the election;
(iv) reasonably relied on the written advice of the Service; or
(v) reasonably relied on a qualified tax professional, and the tax professional failed to make, or advise the taxpayer to make the election.

Under § 301.9100-3(b)(3), a taxpayer will not be considered to have acted reasonably and in good faith if the taxpayer--

(i) seeks to alter a return position for which an accuracy-related penalty could be imposed under § 6662 at the time the taxpayer requests relief and the new position requires a regulatory election for which relief is requested;
(ii) was fully informed of the required election and related tax consequences, but chose not to file the election; or
(iii) uses hindsight in requesting relief. If specific facts have changed since the original deadline that make the election advantageous to a taxpayer, the Service will not ordinarily grant relief.

We have concluded that Taxpayer acted reasonably and in good faith under § 301.9100-3(b)(1). Taxpayer is not under audit and it submitted affidavits indicating that it reasonably relied on the advice of its tax professional, an Organization CPA, who failed to advise Taxpayer to make the election. Therefore, Taxpayer satisfies both §§ 301.9100-3(b)(1)(i) and (v).

In addition, we believe that § 301.9100-3(b)(3) does not apply in this case. Taxpayer asserts that it included its distributive share of the COD income as other taxable income on its 1998 Federal income tax return. Additionally, while Taxpayer's sole shareholder, Shareholder, did not include the COD income on Shareholder's 1998 individual income tax return, Taxpayer represents that Shareholder did attach a statement disclosing the relevant facts pertaining to the COD income along with a copy of Taxpayer's PLR request to the timely filed return. Therefore, because § 6662's accuracy-related penalties could not be imposed, § 301.9100-3(b)(3)(i) does not apply.

Because Taxpayer was not fully informed of the required election and the related tax consequences, § 301.9100-3(b)(3)(ii) does not apply either. Taxpayer asserts, and the affidavit from Tax Preparer substantiates, that it was not informed of the requirement that the § 108(c) election must be made at the corporate level in the case of an S

corporation. Taxpayer states that had it been aware of the necessity to make the election at the corporate level it would have done so in a timely manner.

Finally, it does not appear that Taxpayer used hindsight in seeking relief. Taxpayer timely filed its Year tax return on Date. Less than a month later Taxpayer filed its request for an extension of time to file an election under § 108(c). During this time period no facts have changed which make the election advantageous to the taxpayer.

Section 301.9100-3(c) states that "[t]he Commissioner will grant a reasonable extension of time to make a regulatory election only when the interests of the Government will not be prejudiced by the granting of relief." Under paragraph (i), the interests of the government are prejudiced if granting relief would result in a taxpayer having a lower tax liability in the aggregate for all taxable years affected by the election than the taxpayer would have had if the election had been timely made (taking into account the time value of money). Since Taxpayer continues to own and will make basis reductions in the same property as if the election had been timely made, we believe that Taxpayer will not have a lower tax liability in the aggregate for all taxable years affected by the election than if the election had been timely made.

CONCLUSION

Based solely on the facts as represented and the applicable law, we conclude that the request for relief under § 301.9100-3 of the regulations should be granted.

Accordingly, Taxpayer is granted an extension of time of 45 days from the date of this letter to file an amended return making the election under § 108(c)(3) of the Code. The election is to be made on Form 982.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. This letter does not rule on whether the income at issue is properly treated as cancellation of indebtedness income. This letter also does not rule on whether the income can be excluded from gross income under § 108 of the Code.

A copy of this letter must be attached to any income tax return to which it is relevant.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Assistant Chief Counsel
(Income Tax & Accounting)

By: _____
Christopher F. Kane
Assistant to the Chief
Branch 3

cc: